



COUNCILMEMBER CARL DeMAIO


FIFTH DISTRICT

CITY OF SAN DIEGO

MEMORANDUM

DATE: April 12, 2010

TO: Audit Committee Members

FROM: Councilmember Carl DeMaio 

RE: Response to SEC: Assessment of Five Year Outlook

Item 5 of today's Audit Committee meeting consists of a discussion of the response to the Securities and Exchange Commission (SEC) from the City of San Diego regarding the final report from Independent Consultant Stanley Keller.

Recommendation #22 of the Final Report specifically states that¹

"The City should assess the value of its current Five-Year Financial Outlook as a planning tool, and consider use of additional planning tools, for ensuring that the City is able to meet its goals for providing services to the citizens of San Diego at a cost they are willing to bear."

I believe that the Five Year Outlook has been an extremely useful financial planning tool. However, it can and should be improved.

As the City moves to confront its financial challenges in a structural fashion, several additions must be made to the Outlook to increase its effectiveness; specifically to allow decision-makers to accurately gauge the year-over-year progress of the city's finances, as well as long-term trends.

Last August, I released a memorandum outlining some suggested improvements to the Five Year Forecast.² Two areas touched on by that memorandum include the City's retiree health care and deferred maintenance liabilities.

¹ Keller, Stanley. *Third Annual and Final Report of Independent Consultant to the City of San Diego*. February 24, 2010, pg. 8.
Also see IBA Report # 10-32, pg. 3.

² *Updating the City's Five-Year Financial Forecast*. August 17, 2009.



Retiree Health Care

Since that time, the City Council amended the City's Budget Policy with respect to the treatment of the retiree health care liability in the Five Year Outlook. In particular, the Budget Policy now requires that the following items are reported for the years covered in the Outlook:

- 1) Annual Required Contribution (ARC)
- 2) Pay-as-you-go (PAYGO) costs
- 3) Unfunded Actuarial Liability (UAL)

These three items must also be reported for each of the following scenarios:³

1. "Based on current funding strategy of pay-as-you-go plus some additional amount for pre-funding future liability for retiree health (lower than the ARC)
2. Based on payment of the full ARC each year."

While this new requirement does not solve the issue of funding or reforming retiree health care, it will more clearly display the impact of funding only PAYGO costs plus some additional amount (traditionally \$25 million annually) for the city's annual retiree health care bill. Furthermore, it will more clearly display whether or not the City is adding to or reducing its unfunded liability on a year-over-year basis.

Deferred Maintenance

The Audit Committee has recently taken an active role in trying to help improve the City's financial handling of its Deferred Maintenance backlog. For example, when approving the FY 2009 CAFR, the Audit Committee directed that an amendment be made to the Letter of Transmittal to acknowledge that certain assets were being omitted from the calculation of the total backlog.⁴

At a subsequent meeting, the Audit Committee expressed its support for IBA Structural Deficit Elimination Principle #11, which states:

"Adequately fund deferred infrastructure and maintenance needs annually to ensure that the problem is not growing, and to reduce the potential of increased costs."

The Committee also supported the creation of a draft Council Policy related to funding deferred maintenance, identifying the maintenance backlog comprehensively, identifying annual routine maintenance costs and a forward-looking plan for amortizing the asset maintenance backlog.⁵

³ See Resolution Number R-305348. *A Resolution of the Council of the City of San Diego Approving the City Budget Policy*. March 5, 2010.

⁴ See Audit Committee Actions, Item 1. January 25, 2010. Acknowledged asset exclusions in the final FY 2009 CAFR from the deferred maintenance calculation include alleys and sidewalks, plus soft costs.

⁵ See Audit Committee Action, Item 6. February 1, 2010.

The most recent timetable for addressing the City's structural deficit indicates that the Budget and Finance Committee will discuss the comprehensive treatment of the City's deferred maintenance backlog at its June 23, 2010 meeting. I look forward to participating in this discussion and contributing to the improvement of the City's handling of its deferred maintenance backlog.

In the first Five Year Outlook that is released following the adoption of a new comprehensive approach toward addressing the City's deferred maintenance liability, I am hopeful that the approach I suggested last August will be implemented, specifically that:⁶

"...deferred maintenance should ideally be treated in a fashion (mathematically) analogous to the retiree medical obligation or pension liability. The funding plan for deferred maintenance should be included in the 5 Year Forecast, with a discussion of the forecasted impact to the most recent estimate of the city's deferred maintenance backlog."

However, until this approach toward the city's asset maintenance liability has been finalized and implemented, the Five Year Outlook does not project funding requirements for city assets in a comprehensive fashion. This creates an issue with the proposed response to the SEC being considered by the Audit Committee today.

Requested Action:

I suggest the following (strikeout and underline) amendment to the IBA's proposed response to the SEC on Recommendation 22:⁷

...The Outlook projects funding requirements for the City's priority areas including the City's pension obligation, General Fund reserves, ~~deferred maintenance and capital improvement needs~~, retiree health benefits, storm water obligations, obligations under the Americans with Disabilities Act, City's workers' compensation fund reserves, and City's public liability fund reserves. The City is currently developing a comprehensive liability treatment of its deferred maintenance and capital improvement needs that will be incorporated into the Five Year Outlook upon completion in FY 2011. This calculation has been recommended by the City's Audit Committee. The Outlook is updated, revised and issued annually to reflect the most current revenue and expenditure projections and programmatic budget issues.

Thank you for your consideration of this improvement to the Five Year Outlook and recommended revision to the SEC response.

CC: Honorable Mayor and City Councilmembers
Independent Budget Analyst

⁶ Updating the City's Five-Year Financial Forecast. August 17, 2009.

⁷ See Attachment 1 to IBA Report 10-32, pg. 11 of 13.